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Supreme Court, U.S.
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No. 03-1384

IN THE

Supreme Court of the United States

CHERYL JANE FOLLOWELL,
AS PERSONAL REPRESENTATIVE OF THE ESTATE OF
BETTY JEAN GURLEY,
Petitioner,

v.

GEORGE E. MILLS, JR.,
CHAPTER 7 TRUSTEE,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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In his brief in opposition, Respondent remarkably contends that the lower courts' decisions on res judicata are consistent with this Court's decisions in *Archer v. Warner*, 538 U.S. 314, 123 S. Ct. 1462, 144 L. Ed. 2d 454 (2003); *Federated Department Stores v. Moitie,* 452 U.S. 394, 101 S. Ct. 2424, 69 L. Ed. 2d 103 (1981) and *Brown v. Felsen*, 442 U.S. 127, 99 S. Ct. 2205, 60 L. Ed. 2d 767 (1979). Opposition ("Opp.") at 8. In this reply, we show that Respondent's contentions are without merit and that certiorari should be granted because the lower courts' decisions are inconsistent with and cut squarely against the spirit of this Court's decisions on res judicata in bankruptcy cases.

Further, Respondent contends that the lower courts did not err in ignoring the plain language of 11 U.S.C. § 502(h); but, rather that it is Petitioner's use of section 502(h) as a basis for her claim that is inconsistent with Respondent's perception of the meaning and purpose of the statute. Opp. at 11. As demonstrated in the Petition and below, the lower courts' decisions (i) completely ignore the plain meaning of the language of 11 U.S.C. § 502(h); (ii) are inconsistent with the legislative intent, if it is necessary to reach that question in the first instance; and (iii) serve to strip a non-debtor spouse of her interest in property without providing a mechanism for recognizing as a claim the value of her independent interests in property which is included in her spouse's bankruptcy estate.

Finally, Respondent contends that the "Florida Bankruptcy Court's well reasoned decision to grant summary judgment" fails to implicate novel issues or issues of importance to third parties. Opp. at 2-3. It is important to recognize that it was the Respondent, not the Florida Bankruptcy Court, who authored the decision appealed from.[1] As argued below, the

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[1] It is important to recall that the decision of the Florida Bankruptcy Court authored by Respondent is a 180 degree departure from the position he advocated in the Tennessee Bankruptcy Court. There Respondent fully supported and argued for Mrs. Gurley's right to a claim against to the

lower courts were required to review the trial court's decision with heightened scrutiny and to "engage in a more careful analysis" because of its virtual verbatim adoption of the proposed findings of fact and conclusions of law submitted by the Respondent. *In re Who's Who Worldwide Registry, Inc.* 232 B.R. 38, 48 (E.D.N.Y 1999)(quoting *United States v. El Paso Natural Gas Co.,* 376 U.S. 651, 656-57, 84 S. Ct. 1044, 1047, 12 L. Ed. 2d 12 (1964)). Moreover, the decisions below set dangerous precedent by which aggressive bankruptcy trustees may include jointly owned property in one spouse's bankruptcy estate and eliminate any claim by a non-debtor spouse for her interest in the property.

1. Respondent's characterization of the various stages of the proceedings in this extensive case is misleading and incorrect. *Gurley I,* as defined by Respondent, was not "Mrs. Gurley's first litigation of her interest in assets that are part of the Debtor's estate." Opp. at 5. *Gurley I* was a "Complaint Seeking to Recover Property of the Estate Pursuant to 11 U.S.C. §§ 544(b), Fla. Stat. sec. 726.105(1)(a) and (b), and 28 U.S.C. § 3304(a) and (b)." App. 7a. Respondent's loose assertion that this was Mrs. Gurley's litigation is wholly inaccurate and misleading. Notwithstanding that the litigation in *Gurley I* did not directly involve Mrs. Gurley's interest in assets (rather it involved the question of whether *Mr.* Gurley held *any* legal or equitable interest by virtue of *his* interest in the property), Mrs. Gurley's claim could not have arisen until after the transfers were set aside and the value of

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Memphis Bankruptcy Court. That "under section 502(h), B.J. Gurley [Mrs. Gurley], as the recipient of a fraudulent transfer who is forced to surrender the property by virtue of the Orlando Bankruptcy Court's judgment ***has the right to file a claim*** *against W.M. Gurley's estate.*" *Id.* at 22 (emphasis added). Remarkably, the Trustee even went so far as to point out to the Memphis Bankruptcy Court that "[t]he fact that a fraudulent transferee may file a proof of claim in the transferor's bankruptcy court is found in several authorities." *Id.* at 21.

the transfers was returned to the estate. 11 U.S.C. § 502(d). *In re Republic Trust & Sav. Co.*, 897 Fd.2d 1041, 1045-46 (10th Cir. 1990) *cert. denied by Hackler v. Langenkamp,* 498 U.S. 896, 111 S. Ct. 245, 112 L. Ed.2d 204, and *cert. granted, jmt. rev'd by Langenkamp v. Culp,* 498 U.S. 42, 111 S. Ct. 330, 112 L. Ed.2d 343 (1990) (reversed on other grounds) (stating "appellants cannot possibly become creditors of the estates until after the conclusion of the adversary proceedings [to avoid transfers] against them."). *Id.* at 1046 n.4.

Gurley II, as defined by Respondent, was not "Mrs. Gurley's second litigation of the value of her interest in the assets which the Florida Bankruptcy Court ruled were part of Mr. Gurley's estate." Opp. at 6. Rather, *Gurley II* was the litigation in the Tennessee Bankruptcy Court which, as conceded by Respondent, found that "every asset listed in the Florida Bankruptcy Court's Order of September 16, 1997, was included in Mrs. Gurley's bankruptcy estate." Opp. at 5 (bold in original omitted). No valuation was conducted in *Gurley II* but it is undeniable that the Tennessee Bankruptcy Court found that Mrs. Gurley had a "legal or equitable interest" in the assets. *In re Gurley,* 222 B.R. 124, 145 (Bankr. W.D. Tenn. 1998). *Gurley II* affirmed the existence of Mrs. Gurley's interest in all the assets but recognized the Florida Court's Amended Judgment as a claim against her. Subsequent to *Gurley II*, the Tennessee Bankruptcy Court conducted a valuation hearing and it properly valued the ***entire*** properties which were the subject of the Florida Bankruptcy Court's Amended Judgment. No separate value was assigned to Mrs. Gurley's interest in these assets, for to do so would have been tantamount to the Tennessee Bankruptcy Court allowing a claim in the Florida Bankruptcy Court—clearly an incongruous result.

Respondent's characterization of *Gurley III,* as an attempt to reclaim "that which has been finally and irrevocably determined to belong to her widower's estate" is a deceptive

statement at best. Mrs. Gurley is not attempting to reclaim the assets included in her husband's estate. To the contrary, Mrs. Gurley is simply asserting a claim under section 502(h) for the value of ***her*** independent ownership interest in property which was included in and which she returned to her husband's estate and about which there exit genuine issues of material fact.

2. The lower courts' holdings are in no way consistent with this Court's decisions in *Archer Moitie*, and *Brown* and, in fact, cut squarely against the spirit of these decisions on res judicata in bankruptcy cases. Rather than addressing the substantive policy arguments considered by this Court in *Archer* and *Brown*, Respondent characterizes these important decisions as being factual dissimilar and somehow limited to their facts. Virtually identical policy implications exist here. For example, res judicata does not serve the orderly process of justice nor does it free the courts to resolve other disputes in the allowance of claims under section 502(h) because requiring a litigant in a transfer avoidance action to simultaneously litigate the allowance of her claim needlessly increases the time and cost associated with avoidance litigation. Similarly, in transfer avoidance actions persons "cannot possibly become creditors of the estate until after the conclusion of the adversary proceedings [to avoid transfers] against them. *In re Republic Trust & Sav. Co.*, 897 Fd.2d 1041, 1046 (10th Cir. 1990). Thus, it is always premature to address allowance of claims before the conclusion of the transfer avoidance stage.

Respondent's argument that confirmation of Mrs. Gurley's plan is res judicata as to the allowance of her claim is similarly flawed. This Court has held that orders confirming plans of reorganization are entitled to res judicata effect (*Stoll v. Gottlieb,* 305 U.S. 165, 59 S. Ct. 134, 83 L.Ed. 104 (1938), *reh. denied*, 305 U.S. 675, 59 S. Ct. 250, 83 L.Ed. 437 (1938)); however, the fallacy of Respondent's argument is his presupposition that the Plan in Mrs. Gurley's chapter 11 case

in the Tennessee Bankruptcy Court foreclosed her pursuit of her claim. It did not.

First, Mrs. Gurley expressly preserved the right to continue to pursue her claims against her husband's bankruptcy estate in her Third Amended Plan of Reorganization (the "Plan"). The Plan vested all property of the estate (including Mrs. Gurley's claims against her husband's estate) in Mrs. Gurley. Plan at Section 8. C. Respondent was fully aware of the existence of the claims against the Debtor's estate which is most aptly demonstrated by the fact that (i) the claim was filed on October 16, 1997, nearly one full year prior to confirmation; and (ii) Respondent objected to the claim on April 24, 1998, several months before confirmation of the Plan. Additionally, the claim unmistakably states that it is a "claim under § 502(h)."

Secondly, Respondent's contention that res judicata applies because Mrs. Gurley "should have and could have raised the issue of the value of her interest in the assets at the time the Tennessee Bankruptcy Court was considering the value of the Trustee's interest in the assets" (Opp. at 10) is nonsensical because it purports to confer jurisdiction to the Tennessee Bankruptcy Court over the claims allowance process in the Florida Bankruptcy Court. Respondent ignores the fact that the Plan did not purport to address the allowance of her pending claim against her husband's estate but simply provided for payment of the value of the assets recovered by the Respondent under section 550. The Tennessee Bankruptcy Court did not and could not attempt to address the allowance of a claim in another bankruptcy case pending in another court. Thus, Respondent's suggestion that Mrs. Gurley failed to obtain allowance of her claim in the Tennessee Bankruptcy Court or through an appeal of the Tennessee Bankruptcy Courts' decisions is meritless.

Finally, Respondent does not seriously dispute that the lower courts have ignored the decisions of the Tennessee

Bankruptcy Court which determined that Mrs. Gurley in fact held an interest in the assets independent of that which was transferred because he cannot. The Tennessee Bankruptcy Court held that Mrs. Gurley held an interest in all the assets subject to the Florida Bankruptcy Court's amended judgment and that her interest was property of her chapter 11 estate. *In re Gurley*, 222 B.R. at 130. How can this interest, recognized by the Tennessee Bankruptcy Court, have no value? How can this interest be ignored in evaluating the existence of a claim against the Debtor's estate?

Respondent likewise does not contest that Mrs. Gurley held interests in the properties in question. This capitulation is evidenced by his failure to respond in any fashion to Petitioner's extensive analysis of her interest in the numerous pieces of real property located in Tennessee (Pet. at 15-20). Respondent, for example, does not contest (i) that the properties were acquired; (ii) the dates of the acquisitions; or (iii) that the properties were acquired and owned as tenants-by-the-entirety (for as many as twenty (20) years in some cases). These facts, coupled with Respondent's acknowledgment that Mrs. Gurley would have had a claim even if her appeal of the fraudulent transfer action been successful, are clear indications that Mrs. Gurley held interests in property which have been included in her husband's bankruptcy estate and for which she has not been compensated.

There are genuine factual disputes that exist concerning the value of Mrs. Gurley's entireties interest on the petition date which no court has ever resolved and which dictate reversal of the lower courts' orders granting summary judgment in favor of Respondent. The lower courts' incorrect application of the doctrine of res judicata to avoid addressing these admittedly difficult issues is in conflict with this Court's teachings in *Brown* and *Archer* and the Petition should be granted to correct this error. This issue is undoubtedly important to Petitioner; however, its implications are considerably

broader in scope. Left unchecked the lower courts will be free to avoid addressing the allowance of claims of transferee creditors by simply holding that transferees should have litigated the allowance of their claims together with their defense of the avoidance action. This result is clearly not countenanced by the Bankruptcy Code and fails to satisfy the policy goals of res judicata.

3. Respondent contends that the lower courts' interpretations are "consistent with the plain language of the statute." Opp. at 11. This is argument is demonstrably wrong. The plain language of 11 U.S.C. § 502(h) clearly and unambiguously supports allowance of Mrs. Gurley's claim. The plain language of section 502(h) states that claims arising from recovery of property under section 550 are to be allowed or disallowed as if such claim had arisen prepetition. 11 U.S.C. § 502(h). Section 550, provides that, to extent a transfer is avoided under sections 544, 545, 548, 549, 553(b) or 724(a), the trustee may recover the value of the property from certain transferees. 11 U.S.C. § 550. Mrs. Gurley was the recipient of transfers that were avoided under 11 U.S.C. § 544(b), and which transfers were recovered from her under section 550. Thus, having returned the value of the entire property transferred (not simply the value of Mr. Gurley's interest as suggested by Respondent), she is entitled to a claim for the value of her independent ownership interest in the property.

Respondent relies heavily on the *In re Toy King Distr., Inc.*, 256 B.R. 1 (Bankr. M.D. Fla. 2000), decision, for his argument that section 502(h) claims arise only when the claimant is required to disgorge a payment made to satisfy a valid prepetition obligation. Opp. at 14. *Toy King* itself and others recognize that recipients of fraudulent transfers may be entitled to assert claims under § 502(h). In *Toy King*, the court states a "subsequent transferee is authorized under § 502(h) to pursue a claim against the bankruptcy estate the

same as if such claim had arisen before the date of the filing of the petition" and "[t]o pursue such a claim against the debtor, however, the subsequent transferee must be a creditor of the debtor or be able to assert a claim against the debtor under principles of common law." *Id.* at 204 (quoting *Southmark Corp. v. Schulte, Roth & Zabel, L.L.P. (In re Southmark Corp.)*, 242 B.R. 330, 341 (N.D.Tex.1999)). Similarly, in *In re Best Prods. Co., Inc.*, 168 B.R. 35 (Bankr. S.D.N.Y. 1994), a case involving a fraudulent transfer in a Leveraged Buy Out transaction, the court held "[t]here is an implication in section 550 that a transferee of a fraudulent transfer will have a claim when the transfer is disgorged." *Id.* at 58.

By analogy here, Mrs. Gurley's existing interests in the properties represent consideration given at the time of the acquisition of the property and thus a claim "allowable so long as [she] satisfied the judgment arising out of the fraudulent transfer action." 168 B.R. at 58. This fact is bolstered by Respondent's admission in the brief in opposition that "[h]ad the appellate courts reversed all or part of the Florida Bankruptcy Court's decision, Mrs. Gurley would clearly have had a meritorious claim in the Debtor's estate." (Opp at 7). This statement is an outright admission by Respondent that Mrs. Gurley held a prepetition claim against the Debtor, because it recognizes that she was a creditor and was able to assert a claim against the Debtor as a result of her interest in all these assets irrespective of the portion found to have been fraudulently transferred to her. Opp. at 7.

Respondent similarly contends that section 502(h) applies only to recipients of preferential transfers which are recovered under 11 U.S.C. § 547(b). Opp. 12. A brief look at the evolution of section 502(h) unequivocally demonstrates the Congress' intent to include recipients of fraudulent transfers and preferential transferees in the provisions of

section 502(h). This unambiguous intent is shown by the fact that the Congress consciously chose to expand the provisions of section 502(h) in the final version of the 1978 Code. For example, section 502(h) as originally proposed in the Senate in S. 2266 and in the House in H.R. 8200 provided as follows:

> (h) A claim arising from the recovery of property under section 550 of this title as a result of the avoidance under section 547 of this title of a setoff shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

S. 2266, 95th CONG. 1st SESS. (Oct. 31, 1977)(§ 502(h)); H.R. 8200, 95th CONG. 2nd SESS. (Feb. 8, 1978)(§ 502(h))

As noted above, the final version of H.R. 8200 as enacted provided as follows:

> (h) A claim arising from the recovery of property under section 522(i),[3] 550, or 553 of this title shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

11 U.S.C. § 502(h) (App. at 58a).

The Congress' intent in modifying section 502(h) prior to enactment is expressed in the legislative history which states that "[s]ection 502(h) of the House amendment ***expands*** similar provisions contained in the Senate amendment to indicate that ***any*** claim arising from recovery of property under section 522(i), 550, or 553 shall be determined as though it

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[3] The Congress amended section 502(h) in 1984. Sec. 445(e) of BAFJA provides "Section 502(h) of title 11 of the United States Code is amended by striking out '522(i)' and inserting in lieu thereof '522'." Pub. L. No. 98-353 Title III, § 445(e), July 10, 1984, 98 Stat. 333.

were a prepetition claim." 124 CONG. REC. H11089 *reprinted in* 5 U.S.C.C.A.N. 95th Cong. 2d Sess. (1978) p. 6450 (Sept. 28, 1978) and 124 CONG. REC. S17406 *reprinted in* 5 U.S.C.C.A.N. 95th Cong. 2d Sess. (1978) p. 6518 (Oct. 6, 1978)(emphases added).

Notably, the Congress revisited section 502(h) in 1984 where it amended the language clarifying its application to transfers avoided under 522. *See* n. 3 *supra.* Clearly, the Congress knows what section 502(h) provides and its language is clear. Claims arising from recovery of property under section 550 shall be allowed or disallowed the same as if the claim had arisen before the petition date. Mrs. Gurley's claim is such a claim and the lower courts erred in ignoring this plain language and intent and incorrectly limiting application of 502(h) solely to preference claims.

* * * *

The petition presents a clear case of a court of appeals which has decided an important question of federal bankruptcy law that (i) on the issue of res judicata, conflicts with this Courts' prior decisions and (ii) on the issue of the allowance of a claim under 11 U.S.C. § 502(h), has not been, but should be, settled by this Court. Accordingly, the Court should grant the petition.

CONCLUSION

For the reasons stated herein and in the petition, the petition for certiorari should be granted.

Respectfully submitted,

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